Supreme Court of the United States

OCTOBER TERM, 1971

No. 71—1130

CARGILL, INCORPORATED, ERWIN E. KELM, H. ROBERT DIERCKS, WALTER B. SAUNDERS and BENJAMIN S. JAFFRAY,

Petitioners,

vs.

CLIFFORD M. HARDIN, Secretary of Agriculture, THOMAS J. FLAVIN, Judicial Officer by Appointment of the Secretary of Agriculture, and the UNITED STATES DEPARTMENT OF AGRICULTURE,

Respondents.

BRIEF OF BOARD OF TRADE OF THE CITY OF CHICAGO AS AMICUS CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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Preliminary Statement

A petition for writ of certiorari to the United States Court of Appeals for the Eighth Circuit was filed on March 6, 1972 by Cargill, Incorporated and certain of its officers (collectively "Cargill"). They seek review and reversal of the decision in *Cargill, Inc. et al.* v. *Clifford M. Hardin et al.*, Appeal No. 20,597 (8th Cir., December 7, 1971), in which the Court of Appeals found that Cargill had manipulated the price of May 1963 wheat futures contracts in violation of § 6(b) of the Commodity Exchange Act as amended [7 U.S.C. § 9].

The Board of Trade of the City of Chicago (hereafter "Board of Trade"), with the prior written consent of all parties below, has entered its appearance as *amicus curiae* to urge that the petition of Cargill be granted and to submit, at a later date, a brief on the merits urging rejection of certain erroneous legal principles fashioned by the Court of Appeals in reaching its decision below.

The Board of Trade urges that the petition of Cargill be granted for each of the following reasons:

1. The decision of the Court of Appeals is in direct conflict with the decision of the Court of Appeals for the Fifth Circuit in *Volkart Bros., Inc.* v. *Freeman*, 311 F.2d 52 (5th Cir. 1962), dealing with the same issues of law and having analogous facts. This conflict is repeatedly recognized by the Court of Appeals in its decision below.

2. The decision of the Court of Appeals is in conflict with the rulings of the United States Supreme Court in *Board of Trade of the City of Chicago* v. *Christie Grain & Stock Co.*, 198 U.S. 236 (1905).

3. The decision of the Court of Appeals is in conflict with applicable state laws governing the legality of commodity futures trading.

4. The decision of the Court of Appeals concerns an important question of federal law—the definition of "manipulation of prices" in commodities futures trading—which has not been, but should be, settled by the United States Supreme Court.

Nature and Interest of Board of Trade

The Board of Trade is the world's largest marketplace for buying and selling commodity futures contracts. In 1971, over 8.5 million "futures contracts" in wheat, corn, oats, soybeans, soybean oil, soybean meal, silver, plywood,

iced broilers (dressed chickens) and choice steers were traded on the floor of the Board of Trade. The estimated dollar value of the commodities involved in the trading exceeded Eighty-eight Billion Dollars ($88,000,000,000).

The Board of Trade was founded in 1848 and has operated since 1922 as a "contract market" under the Commodity Exchange Act and its precursor, the Grain Futures Act [7 U.S.C. §§ 1-17b]. Under the Commodity Exchange Act, the Secretary of Agriculture has authorized the Board of Trade to provide a futures market for a variety of agricultural products including wheat, the subject of the pending action. In order to obtain such authorization from the Secretary, the Board of Trade has been required to fulfill certain conditions set forth in the Act. For purposes of this case, the principal statutory condition is that the Board of Trade must "provide for the prevention of manipulation of prices and the cornering of any commodity by the dealers or operators upon such board." [7 U.S.C. § 7(d).] Failure by the Board of Trade to comply continually with this anti-manipulation condition can result in the suspension or revocation of the Secretary's authorization to conduct a futures market in regulated commodities. [7 U.S.C. § 7b.] In the absence of the Secretary's authorization, it would be unlawful for the Board of Trade to operate a futures market in regulated commodities. [7 U.S.C. § 6.]

According to publications of the Commodity Exchange Authority, the agency within the Department of Agriculture engaged in administration of the Commodity Exchange Act, the Board of Trade is only one of twenty (20) futures markets in the United States which are subject to the Act. All such markets have the same commitment as the Board of Trade to "provide for the prevention of manipulation of prices and the cornering the any commodity. . . ." [7

U.S.C. § 7(d).] During 1971, futures trading on all such "contract markets", including the Board of Trade, exceeded a dollar value of One Hundred Twenty-five Billion Dollars ($125,000,000,000).

Each of the twenty futures markets supervised under the Act has a direct and vital interest in resolution of the present conflict among the Courts of Appeals. Each futures market is required by the Act to formulate surveillance procedures, record-keeping requirements, and organization staff adequate to meet its statutory responsibility to "provide for the prevention of manipulation." In 1971, the Board of Trade alone spent over $500,000 in its surveillance programs. In addition, hundreds of voluntary man-hours are spent each year by members of the Board of Trade on committees dealing with screening, surveillance, and compliance. Similar compliance structures, aimed in large measure toward providing for the prevention of manipulation and other wrongdoing, exist on other commodity exchanges as well. The effective operation of these surveillance programs cannot be carried out so long as the test of "manipulation" under the Act remains the subject of debate among the Courts of Appeals.

The Legal Issues

I.

The Court of Appeals Has Rendered A Decision In Conflict With The Decision Of Another Court Of Appeals On The Same Matter.

The decision of the Court of Appeals is in direct conflict with the decision of the Court of Appeals for the Fifth Circuit in *Volkart Bros., Inc.* v. *Freeman*, 311 F.2d 52 (5th Cir. 1962), dealing with the same issues of law and having analogous facts. This conflict is repeatedly recognized by the Court of Appeals in its decision below.

The Court of Appeals' acknowledged disagreement with the *Volkart* case is fundamental. The holding in the *Volkart* case is careful to distinguish between natural squeezes (a supply shortage caused by ordinary market forces) and manipulative squeezes (a shortage engineered by market participants). *Volkart* soundly criticizes the latter but recognizes that the former may exist and that persons astute enough to anticipate and profit by them should not be punished as manipulators. (311 F.2d at 59.) On the other hand, the Court of Appeals in the instant case holds that a squeeze can be a manipulation when there is "a shortage of deliverable supplies *for whatever reason*" and the "long" acquires contracts in excess of those "deliverable supplies" (Petition, p. A-15, emphasis supplied.)[1]

In the body of its opinion in the instant case, the Court of Appeals for the Eighth Circuit discusses the holding in *Volkart* and asserts "The Fifth Circuit reached this conclusion without any economic analysis whatsoever and did not discuss its apparent discrepancy with the *Great Western*[2] case." (Petition, p. A-23.) Later in that same paragraph the Court, in reference to part of the *Volkart* decision, states "[W]e do not consider it to be economically realistic." (Petition, p. A-23.)

So complete is its rejection of the *Volkart* case that the Court of Appeals devotes an entire section of its opinion

[1] Citations to "Petition" refer to the Petition for a Writ of Certiorari filed in this case by Cargill *et al.* on March 6, 1972.

[2] *Great Western Food Distributors, Inc.* v. *Brannan*, 201 F.2d 476 (7th Cir. 1953); *cert denied*, 345 U.S. 997 (1953). Comparing *Volkart* and *Great Western*, the Court of Appeals noted a second conflict among the Circuits when it stated that "the two cases available appear to have split on the question." (Petition, p. A-22.) Indeed, the Court of Appeals held that *Volkart* "is in substantial conflict with . . . *Great Western*" and with another decision of the Seventh Circuit (Petition, p. A-36). Thus, not two but *three* Circuits, the Fifth, Seventh, and Eighth, are involved in the present debate over the legal meaning of "manipulation".

(Part V) to a discussion of what it considers to be the inadequacies of the *Volkart* case. As part of that discussion the Court of Appeals castigates the *Volkart* holding in the following terms:

> It is somewhat difficult to discern why the Court reached this result, but apparently its concern was that a contrary result would relieve the shorts of their delivery obligation and transform the futures contract into a gambling transaction. We think this approach disregards commercial reality and the economic functions of the futures market. (Petition, p. A-37.)

This open and apparent difference of opinion between the respective Courts of Appeals should be settled by the United States Supreme Court.

II.

The Court of Appeals Has Decided a Federal Question Contrary To the Decision of the United States Supreme Court.

No principle is more firmly fixed in the law of commodity futures trading than that the delivery obligation inherent in such contracts is legally binding upon the parties.

In the first decade of this century, commodity futures trading was repeatedly attacked under state "bucket shop" laws on the ground that the delivery obligation in futures contracts was merely "pretended" and not binding. In *Board of Trade of the City of Chicago* v. *Christie Grain & Stock Co.*, 198 U.S. 236 (1905), the Supreme Court laid this issue to rest as to Board of Trade futures contracts by concluding that the delivery obligation on such contracts is legally binding and, upon maturity, the "short" must be prepared to deliver and the "long" must be prepared to receive and pay for that delivery. As Justice Holmes stated:

> There is no doubt, from the rules of the Board of Trade or the evidence, that the contracts made between the members are intended and supposed to be binding in manner and form as they are made. (198 U.S. at 248-49).

But the Court of Appeals below has ruled flatly against the sanctity of the delivery obligation. This ruling involves three interrelated features:

> *First,* the lower court ruled that "shorts", faced with a natural shortage of the local commodity, need not acquire the commodity elsewhere nor deliver a better grade of commodity from local sources if additional cost to them would result. In effect, the Court of Appeals sanctioned economic disadvantage as a lawful excuse for failure to deliver.
>
> *Second,* the lower court ruled that "shorts" are entitled to be released from their futures contracts at a noncompetitive price lower than they would have paid in making delivery from outside sources or in delivering a better grade of the commodity, and that "longs" who demand and receive a price reflecting the cost of delivery risk charges of manipulation.
>
> *Third,* the lower court aimed a broadside at the very concept of delivery, concluding repeatedly that it is an undesirable, disruptive and distorting influence upon prices in the cash market when local supplies are scarce. The Court of Appeals' decision would limit the delivery obligation, at best, to situations where there is an abundant, cheap local supply of wheat or, in cases of supply shortage, to satisfying a current local need for the commodity among cash merchants and processors. Absent such abundance or a demonstrable "need" among local merchants, however, the lower court would permit "shorts" to ignore their delivery obligation, and thereafter to settle with the "longs" at bargain prices.

The opinion of the Court of Appeals relieved the "shorts" of their delivery obligation by constraining the "available supply" of wheat (i.e., what the "shorts" must be prepared to deliver) to soft red winter wheat located in Chicago as of the last day of futures trading. This, notwithstanding that another grade of wheat was acknowledged by the Court to be available which could have been delivered by the "shorts":

> [I]t appears that there were ample supplies of hard wheat in surrounding areas which could have been shipped to Chicago in time for delivery on the future. *** (Petition, p. A-21).

The lower court decided to exclude these "ample supplies" simply because of the additional cost to the "shorts":

> Hard wheat was of a higher grade than No. 2 soft red winter wheat, its price was higher, no premium was allowed for its delivery, and the cost of shipment into Chicago for delivery on the future was an additional economic impediment to its delivery. *** (Petition, p. A-22).

The Court of Appeals then stated that it was more economical for the "shorts" to offset in the futures market with the "longs," even at a premium:

> It would be more economic to pay the long a premium than to pay the additional charges for premium [hard] wheat plus shipping and handling charges. (Petition, p. A-22).

Even though this was "more economic", the lower court refused to place even this responsibility on the "shorts". Instead, the Court of Appeals held that the "shorts" need pay to the "longs" only a price reflecting "historical" norms (Petition, pp. A-25 and A-26), or a price equal to the elusive[3] current "cash price" in Chicago at the time (Petition, p. A-27). And, because the prices paid by these "shorts" to Cargill exceeded the largely theorized "historical" and highly conjectural "current" cash prices, the Court of Appeals concluded that the price was "artificial" and manipulative.

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[3] The lower court readily acknowledged the elusiveness of these cash prices: "The problem with matching theory to fact lies in the difficulty of determining the cash price of wheat, for actual cash trades on the Chicago spot market are relatively infrequent and the prices of individual transactions may vary greatly depending on the positions of the parties, the quantity involved, and the time of the transaction." (Petition, p. A-27).

The lower court's ruling, whereby in local shortage situations the "longs" must somehow confine their bids to "historical" or "current" price ranges, collides not only with the basic nature of the commodity markets as vigorous auction forums, but also presents an irreconcilable conflict with the open and unfettered competition mandated by the Commodity Exchange Act. The Secretary of Agriculture, pursuant to his rulemaking power under the Act, has insisted that "all purchases and sales of any commodity for future delivery . . . shall be executed openly and competitively by open outcry . . . or by other equally open and competitive methods . . . ." [Reg. § 1.38, 17 C.F.R. § 1.38]. Now, in a tacit reversal of that philosophy, the Secretary has successfully urged the Court of Appeals to prohibit vigorous competition between "longs" and "shorts" when a local shortage of the commodity exists. Settle out, says the Court of Appeals, at a price below what competition would produce; otherwise, face the risk of being charged as a "manipulator."

The lower court's methodical emasculation of the delivery obligation, first by excluding from "available supply" all sources involving additional cost to the "shorts" and, second by requiring "longs" to settle with the "shorts" at less than a competitive price, reflects that Court's basic sentiment that delivery on futures contracts during local scarcity is undesirable and should be discouraged.

The Court of Appeals' opinion is laced with criticism of the delivery obligation as such. The lower court clearly inferred that delivery in local shortage situations, if ever justified, should be limited to satisfying a local need among cash merchandisers and processors for the commodity. The Court of Appeals bluntly ruled that delivery for other purposes (such as honoring the obligations of the futures contract) produces a "dislocation" of prices:

> While the obligation to make or take delivery is a bona fide feature of the futures contract, in reality the futures market is not an alternative spot market for the commodity itself .... For most parties who engage in futures transactions are in no position to either make or take delivery, and if they were required to always make preparations to fulfill their obligations to make or take delivery, the number of persons who could effectively participate in the futures market would be substantially restricted, thus reducing the liquidity and volume of that market. The main economic functions performed by the futures market are the stabilization of commodity prices, the provision of reliable pricing information, and the insurance against loss from price fluctuation. The functions can be fulfilled only if both longs and shorts can be assured that they can *offset* their contracts at non-manipulated prices. If in a squeeze situation, the shorts must be forced either to pay manipulated prices to offset their contracts or in the alternative to bring in higher priced outside supplies which are neither wanted or needed in the local market, then both the cash and the futures markets will be dislocated.*** (Petitions, pp. A-37 and A-38, emphasis added.)

And, in response to Cargill's argument that the price received by it on offset merely reflected the costs that "shorts" would have incurred if they had fulfilled their delivery obligation, the Court of Appeals held that such a price is nevertheless "artificial" whenever the local cash market would not need the commodity if it were delivered:

> [W]e have been shown no good reason why the futures price should reflect the cost of bringing in a higher price and grade of wheat for which there is no demand in the local area. It is this price which was artificially high and therefore useless to the trade and nation. (Petition, p. A-38).

The foregoing analysis by the Court of Appeals reflects two unprecedented assumptions:

> *First*, that the demand for cash wheat resulting from the delivery obligation in futures contracts is

not a legitimate demand and should be ignored in determining the extent of local "need" for cash wheat.

Second, that neither delivery nor a futures price reflecting delivery costs is legally justified unless there is a current local "need" (excluding the needs of "shorts") for the cash wheat.

The sentiment of the Court of Appeals that delivery upon futures contracts is a distorting influence upon cash prices in cases of local scarcity, and that the delivery obligation generates demand for cash wheat which is not a legitimate part of the supply-demand equation, attacks the very core of futures trading by cutting it adrift from the cash market. Maintaining a relationship with the cash market is indispensable to the utility of the futures market as a pricing mechanism and as a hedging medium. The Court of Appeals, by its ruling, has gravely threatened that relationship and, in the process, endangers the economic functions of a futures market.

III.

The Court of Appeals Has Decided An Important State Question In A Way In Apparent Conflict With Applicable State Law.

The decision of the Court of Appeals is in conflict with applicable state laws governing the legality of commodity futures trading. Under the doctrine announced by the United States Supreme Court in *Dickson* v. *Uhlman Grain Co.*, 288 U.S. 188 (1933), any dilution of the delivery obligation may render a commodity futures contract subject to challenge under state gaming laws which prohibit futures trading where delivery is not contemplated. The ruling of the Court of Appeals relieves sellers from their delivery obligation under such recurring circumstances of natural supply shortages that state gaming laws may become applicable to prohibit heretofore lawful futures trading.

The Illinois statute against gambling by means of pretended contracts for future delivery of commodities is illustrative of such state statutes. The Illinois statute provides in pertinent part as follows:

> (a) A person commits gambling when he: . . .
>
> (4) Contracts to have or give himself or another the option to buy or sell, or contracts to buy or sell, at a future time, any grain or other commodity whatsoever, or any stock or security of any company, where it is at the time of making such contract intended by both parties thereto that the contract to buy or sell, or the option, whenever exercised, or the contract resulting therefrom, shall be settled, not by the receipt or delivery of such property, but by the payment only of differences in prices thereof: . . . (38 Ill. Rev. Stat. § 28-1.)

In the *Uhlman Grain* case referred to above, the broker represented to the customer that he would not have to make or take delivery of commodities pursuant to trades executed by the broker for the customer's account on the Board of Trade. The Supreme Court found that the broker's oral representation that his customer would not have to make or take delivery relieved the customer of his contract obligation and thus rendered the trades gambling contracts and void.

The Court of Appeals in the instant case has relieved the "shorts" of their delivery obligation whenever there is a "shortage of deliverable supplies for *whatever reason*." (Petition, p. A-15 emphasis supplied.) The Court of Appeals reasons that in a local shortage, if the delivery obligation were enforced, "shorts" would have to bring the commodity in from some distant source of supply, or to deliver a better grade of the same commodity. The added cost is an economic disadvantage and, under the reasoning of the Court of Appeals, is thus a lawful excuse for non-

performance of the delivery obligation. If the "shorts" no longer have an obligation to deliver when they face an economic disadvantage to do so, then the contracts for future delivery and payment may be subject to unwarranted attack under state gambling statutes similar to the Illinois statute quoted above.

IV.

The Court of Appeals Has Decided An Important Question Of Federal Law Which Has Not Been, But Should Be, Decided By The United States Supreme Court.

The decision of the Court of Appeals concerns an important question of federal law—the definition of "manipulation of prices" in commodities futures trading—which has not been, but should be, settled by the United States Supreme Court. "Manipulation of market prices" is proscribed by the Commodity Exchange Act (7 U.S.C. § 9) but neither the Act nor the Regulations thereunder contains a definition of that important term. The self-regulatory system envisioned by the Commodity Exchange Act dictates that the term "manipulation of market prices" have a definition readily discernable to the exchanges and their members.

The Supreme Court has not yet resolved this critical question. Although the Court has considered the definition of "manipulation of prices" in the contexts of securities markets, antitrust enforcement and other commercial regulation, the commodity futures markets introduce new and different factors bearing upon the legal issue. Thus, as in the present case, it is necessary to fashion a legal definition of "available supply" of the commodity in order to determine whether the legally requisite "squeeze" is present. This requires consideration of unique factors such as transportation, handling and storage costs of the commodity,

whether varying grades are commercially interchangeable, whether ungraded supplies should be included and myriad other unique factors of agricultural marketing not confronted in securities or antitrust cases. Moreover, there is the balancing of the open competition mandated by the Commodity Exchange Act and the resultant benefits to the consumer, with the prevention of engineered price squeezes.

As if inviting review by the Supreme Court, the Court of Appeals noted that "There are no Supreme Court precedents on this question under the Commodity Exchange Act" (Petition, p. A-24), and remarked that "Case authority under the Commodity Exchange Act which would aid in the determination of this question is meager indeed, and the two cases available appear to have split on the question." (Petition, p. A-22.) The present proceeding offers a rare opportunity for the United States Supreme Court to remedy this void, which has thus far generated only debate and conflict.

The lower courts, the contract markets, and all participants in futures trading will benefit from a review of the decision below. We respectfully urge that Cargill's petition for a writ of certiorari be granted.

Respectfully submitted,

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